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MANUFACTURERS HANOVER

Financial Digest

Volume XXVII, Number 23 Monday, November 5, 1990

Analysis of Business Trends Plus Selected Financial Indicators

Unification Strains Germany's Public Sector

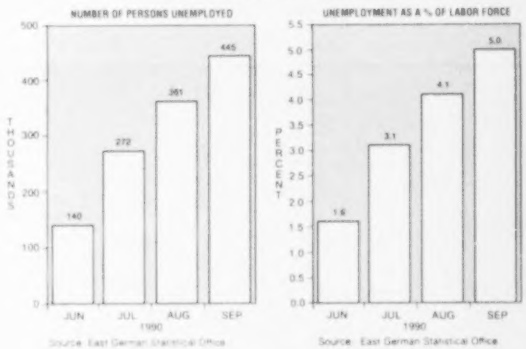
George Bush's lips aren't the only ones that are being closely watched these days. Less than six months ago, the Bonn government had estimated that the cost of financing German reunification would come to around 50 billion marks (about $33 billion) per year (Financial Digest—June 4, 1990). At the same time, Chancellor Helmut Kohl promised that "no one will have to pay for reunification" because a surge in tax revenues due to the robust economic growth that will develop from a united Germany will make it unnecessary to raise taxes.

However, with the cost of German unification soaring well above the original estimates—private economists now think that it may take from $600 billion to $1 trillion over the next ten years to rebuild what was once East Germany—Finance Minister Theo Weigel has already submitted a third extra federal budget for this year. Worse-than-expected economic and environmental conditions in the five eastern states will not only mean less tax revenue from the East, but will also require additional government spending by the West.

Because of the extra strain that financing unification will place on the public sector, Bonn now projects an all-German federal deficit of almost 67 billion marks this year, more than three times the 20 billion mark shortfall that West Germany posted in 1989. However, the Bundesbank thinks that even this estimate may be too low. The German central bank expects that the all-German budget deficit will reach 100 billion marks this year (equivalent to more than four percent of West Germany's economy) and will climb even higher to 130 billion marks in 1991. In fact, many private economists believe that next year's shortfall could exceed 140 billion marks.

What is more, Bonn now concedes that the corporate tax cuts that were supposed to begin in 1991 will have to be delayed for several years. And while Chancellor Kohl, who must face an all-German general election on December 2, is trying to avoid mentioning the taboo subject of taxes for as long as possible, Mr. Weigel now says that taxes will go up "only as a last resort". In fact, four out of five Germans believe that they will be hit with higher taxes after the December elections.

EAST GERMAN UNEMPLOYMENT
SINCE GERMAN ECONOMIC UNIFICATION



Eastern Germany's Economy Stumbles

One reason for the sharper-than-expected deterioration in the economy of what was once East Germany since economic and monetary unification was implemented on July 1 is the rejection by the East Germans of their own shoddy products. Instead, they are now buying their new cars, radios, televisions, and video recorders from West Germany. In addition, rather than set up shop in the east, the West Germans are finding it easier just to sell their products there. As a result, West German retail sales soared by almost 11 percent in volume terms in August from a year ago, following a 14 percent increase in July. With most of East German demand being satisfied by West German products, industrial production in East Germany plunged by over 40 percent in August from the same month a year ago.

The faltering East German economy, in turn, has forced a larger-than-expected number of people to join the unemployment lines. The number of unemployed workers jumped to almost 445,000 in September from barely 100,000 in June, bringing the East German unemployment rate from 1.6 percent in the month before German monetary and economic unification was implemented to five percent just three months later (see chart).

Manufacturers Hanover Economics Department 17/270

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And this is even before any of the more than 2,000 East German firms that are not expected to survive free-market competition have been scrapped. So far, The Treuhand, the East German agency responsible for privatizing the state-owned companies, has avoided the unpleasant task of deciding which firms are not viable. Once these companies go under, the number of unemployed workers will soar even higher, possibly to as much as two million—or one-fourth of East Germany's workforce—by early next year. As a result, the East German economy is expected to contract by around ten percent in inflation-adjusted terms this year and by a similar amount in 1991.

Higher-than-expected unemployment is not only boosting government outlays for social benefits, but it is also reducing employee contributions to health, social security and pension funds, requiring the public sector to cover huge shortfalls in these areas. As a result, total welfare payments are expected to reach almost 20 billion marks this year and 30 billion marks in 1991.

The Costs Keep Soaring

Welfare benefits aren't the only costs that are soaring by the day. Bonn has also promised to

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (10/17/90)	207,861	+ 1,009	- 11,122
New York City (10/24/90)	35,428	- 794	- 6,950
Commercial Paper (10/24/90)	557,646	- 5,807	+ 46,182

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (10/17/90)	317,908	+ 640	- 60
New York City (10/24/90)	57,305	+ 469	- 2,759

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (10/17/90)	1,019,039	+ 2,294	+ 31,150
New York City (10/24/90)	177,583	- 950	- 6,063

Financial Markets

	Friday 11/2/90	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	7.28%	- .07	- .80
180-Day Bills†	7.38	- .06	- .68
Longest Bills†	7.34	- .07	- .64
Recent Issues:			
7¼s 10/31/92	7.66	NA	
8½s 9/15/94	8.01	- .08	
8¼s 8/15/00	8.57	- .05	
8¼s 8/15/20	8.70	- .06	
Municipals:			
Bond Buyer—20 Bond Index* (11/1/90)	7.29%	- .14	+ .05
Blue List Total ($ Million)	$ 890	- $ 35	- $ 762
30-Day Visible Supply ($ Million)	$1,065	- $866	- $ 926
Total	$1,955	- $901	- $1,688
Corporates:			
Moody's Aa Composite (11/1/90)	9.69%	- .05	+ .55
30-Day Visible Supply ($ Million)	$ 650	- $442	- $1,870
Stocks:			
Dow-Jones Averages:			
Industrials	2,490.84	+ 54.70	- 138.67
Transportation	842.46	+ 5.37	- 369.31
Utilities	215.92	+ 7.23	- 3.77
65 Stocks	879.43	+ 17.78	- 127.05
N.Y.S.E. Composite Index	170.07	+ 3.36	- 17.21
N.Y.S.E. Avg. Daily Vol. for Week (000's)	154,466	+ 10,488	+ 5,536

*34% Taxable equivalent 11.05%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 11/2/90	Week Ago
Overnight	8.00%	7.88%
1 month	7.88	7.88
3 month	7.94	8.00
6 month	7.94	7.94
1 year	8.00	7.94

FOREIGN EXCHANGE SPOT RATES

New York Opening (11/2/90)	Currency Per U.S. $	Week Ago
Belgium	30.91	31.14
Canada	1.1649	1.1655
France	5.0400	5.0670
Germany	1.5020	1.5140
Italy	1128.20	1133.00
Japan	128.75	127.70
Mexico	2922.60	2917.80
Netherlands	1.6938	1.7055
South Korea	703.99	705.77
Switzerland	1.2720	1.2790
Taiwan	26.77	26.79
U.K.*	1.9520	1.9597

*U.S. $ per U.K. pound

MH TRADE-WEIGHTED DOLLAR (11/2/90) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/85
	+0.7%	-0.1%

honor East Germany's trade contracts with Eastern Europe. Originally estimated at three billion marks, the cost of these guarantees is now expected to be as high as six billion marks. At the same time, with East Germany's roads, railroads, telephone system and pollution problems even worse than anticipated, the money needed for infrastructure and cleaning up the environment is growing rapidly.

Bills from abroad will be coming in, too. In order to win its endorsement for German unification, Bonn promised the Soviet Union 15 billion marks to cover the cost of Soviet troop withdrawal from East Germany. What is more, in order to demonstrate that a United Germany will fulfill its international obligations, the government has pledged over three billion marks for the American-led military operation in the Gulf and for economic aid to Egypt, Jordan and Turkey.

As the costs of unification mount, Chancellor Kohl's no-new-taxes pledge is looking increasingly vulnerable. So, although his lips are firmly sealed now, all Germans will be waiting to read them—or those of his Socialist rival Oskar Lafontaine—after December 2. ■

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 10/31/90	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	241.223	+ .238	+19.736
Loans to Depository Inst.	.430	+ .064	+ .115
Float	.685	- .248	- .013
Total Reserve Bank Credit	284.388	+ .524	+23.877
Treasury Deposits with Federal Reserve Banks	6.274	+ 1.343	- .162
Currency in Circulation	274.533	- .296	+25.742
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	240.993	+ 2.201	+ 7.609
	10/31/90		
Member Bank Reserves:			
Total Reserves Held	58.194	- 2.159	- .441
Excess (Deficiency)	.635	- .387	- .493
Net Free Reserves	.263	- .371	- .543
Monetary Aggregates †		**‡ % Change Since 3 Months Ago***	**Year Ago**
M1 (10/22/90)	818.8	+ 5.5	+ 4.4
M2 (10/22/90)	3,318.7	+ 4.4	+ 4.6
M3 (10/22/90)	4,091.0	+ 3.3	+ 1.9
Domestic Nonfinancial Debt (2nd Q'90)	10,126.6	+ 6.3	+ 7.3

† Seasonally adjusted. * Seasonally adjusted annual rate. ‡ Four-week moving average.

New York Money Market

Offering Rates 11/2/90	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	7.05%	7.02%	6.86%
* Federal Agencies	7.75	7.65	7.70
* Municipal Notes–High Grade (34% Taxable Equivalent)	8.48	8.78	8.93
Negotiable Time CDs			
Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	8.00	8.00	8.00

‡ Finance Company Paper–Prime

5- 14 days	7.73%
15- 29 days	7.73
30- 59 days	7.68
60- 89 days	7.80
90-179 days	7.68
180-239 days	7.50
240-270 days	7.50

‡* Bankers' Acceptances

Dec.	7.78%
Jan.	7.92
Feb.	7.73
Mar.	7.69
Apr.	7.65
May	7.59

‡ Industrial Paper–Prime

30- 89 days	7.78%
90-120 days	7.75

†Federal Funds Effective Rate 7.88%

‡ Discount basis. *Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)*

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	3rd Q'90n	$ 5,514	$ 5,443	$ 5,239
Gross National Product (1982 Dollars)*	3rd Q'90n	$ 4,174	$ 4,155	$ 4,130
Percent Change, Annual Rate	3rd Q'90n	1.8	0.4	1.7
Change in Consumer Prices*	Sep '90	9.6 %	9.6%	2.4%
Change in Mfg. Cost of Living Index*	Sep '90	4.8 %	4.8%	6.0%
Change in Producer Prices*	Sep '90	19.2 %	15.6%	8.4%
Civilian Employment (Thousands of Persons) †	Oct '90n	117,711	117,898	117,585
Unemployment as % of Civilian Labor Force †	Oct '90n	5.7%	5.7%	5.3%
Personal Income*	Sep '90n	$ 4,697	$ 4,673r	$ 4,412
Leading Indicators Composite Index (1967=100) †	Sep '90n	143.3	144.4r	145.0
Industrial Production Index (1977=100) †	Sep '90	110.7	110.4	108.2
Net Change in Consumer Installment Credit †	Aug '90	$ 2.09	$ 4.73	$ 3.52
U.S. Merchandise Trade Balance †	Aug '90	- $ 9.34	- $ 9.12	- $ 10.33
Plant and Equipment Expenditures*	4th Q'90	$ 538.6(a)	$ 532.5(a)	$ 519.6
Private Housing Starts (Thousands of Units)*	Sep '90	1,135	1,142	1,263
New Construction Expenditures*	Sep '90n	$ 428.7	$ 441.1r	$ 433.4
Total Business Inventories †	Aug '90	$ 806.5	$ 802.2	$ 791.4
Total Business Sales †	Aug '90	$ 551.9	$ 540.4	$ 531.6

*Seasonally adjusted annual rate. † Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

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